

Letter of Findings Number: 04-20140179
Use Tax
For Tax Years 2010-12

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register.

ISSUE

I. Use Tax—Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-1; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#).

STATEMENT OF FACTS

Taxpayer is an Indiana manufacturer. The Indiana Department of Revenue ("Department") conducted an audit for tax years 2010, 2011, and 2012. The audit resulted in the assessment of sales and use tax for those years. Taxpayer protested the imposition of use tax on a power conveyor system used in its business. An administrative hearing was conducted and this Letter of Findings results. Further facts will be presented as required.

I. Use Tax—Imposition.

DISCUSSION

Taxpayer protests a portion of the use tax imposed for tax years 2011 and 2012. The Department reviewed Taxpayer's purchases and imposed use tax on items of tangible personal property ("TPP") upon which sales tax had not been paid at the time of purchase. Taxpayer argues that, as a manufacturer, use tax should not be applied to its purchases of machinery used directly in production. Specifically, Taxpayer protests use tax imposed on a power conveyor system it uses to move Taxpayer's product through the packaging process. Taxpayer manufactures its product which is then purchased in specifically bundled units by customers. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

Sales tax is imposed by IC § 6-2.5-2-1, which states:

- (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
- (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

[45 IAC 2.2-3-4](#) further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property ("TPP") is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction, or if there is an applicable exemption to sales and use taxes.

The Department refers to IC § 6-2.5-5-1(b), which exempts TPP transactions where the TPP is used in direct production:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing. (Emphasis added).

[45 IAC 2.2-5-8\(c\)](#) further states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. (Emphasis added).

[45 IAC 2.2-5-8\(d\)](#) goes on to specifically address packing in the production process:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required. (Emphasis added).

Therefore, manufacturing machinery is exempt from sales and use tax if the machinery is used directly in production of other TPP for sale. Production can include packaging when packaging occurs before TPP reaches its completed form. Packaging must play an essential and integral part in the production of TPP in order for it to be part of the manufacturing process.

In the instant case, Taxpayer protests use tax imposed on its power conveyor system used to transport the individual items through a packaging process. It argues that packaging is required before the product reaches its final form. Taxpayer states that its final product is not the individual items, but rather is a bundle of items that are stacked and packaged according to specific customer orders.

Taxpayer provided documentation showing that its customers cannot buy the items individually, but instead its customers purchase the items exclusively in pre-ordered and specially arranged bundled units. These bundled units are stacked and packaged based on customer specifications provided in the order form. Therefore, the "product" which Taxpayer manufactures is not the individual items but rather is the bundled unit. In other words, the packaging operation which takes place after the use of the power conveyor system in question constitutes product packaging, not shipping activities. Since the specifically ordered and bundled unit is the final product, Taxpayer's production process is not complete until the bundled unit is bundled, as provided by [45 IAC 2.2-5-8\(d\)](#). The power conveyor system in question is therefore moving work-in-process and is part of Taxpayer's manufacturing activities and is therefore eligible for the exemption explained by [45 IAC 2.2-5-8\(c\)](#). After reviewing this documentation, the Department determined Taxpayer is not required to pay use tax on its power conveyor system used for transporting the items through the previously described packaging process. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

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